

Message Text

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ACTION EUR-25

INFO OCT-01 ISO-00 AID-20 CIAE-00 COME-00 EB-11 FRB-03

INR-11 NSAE-00 RSC-01 TRSE-00 XMB-07 OPIC-12 SP-03

CIEP-03 LAB-06 SIL-01 OMB-01 DODE-00 PM-07 H-03 L-03

NSC-07 PA-04 PRS-01 SS-20 USIA-15 FEA-02 SCI-06 COA-02

AGR-20 STR-08 DRC-01 /204 W
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R 061800Z SEP 74

FM AMEMBASSY REYKJAVIK
TO SECSTATE WASHDC 4806
INFO AMEMBASSY BRUSSELS
AMEMBASSY COPENHAGEN
AMEMBASSY HELSINKI
AMEMBASSY OSLO
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USMISSION NATO
CINCLANT
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BRUSSELS FOR USEC

PARIS FOR USOECD AND RFC

EO 11652: NA

TAGS: ECON EFIN ELAB IC

SUBJECT: DEVALUATION AFTERMATH - OTHER ECONOMIC ISSUES

REF: REYKJAVIK 1197

1. WHILE THE GOVT CONTINUES TO TAKE STEPS TO PUT
COUNTRY'S ECONOMIC HOUSE IN ORDER, ADJOURNMENT OF PARLIAMENT
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SEPT 5 AND POSTPONEMENT OF TRADITIONAL OCT 10

OPENING OF NEW PARLIAMENT UNTIL OCT 29 RAISE QUESTIONS REGARDING GOVT ECONOMIC STRATEGY. TWO MONTH INTERVAL, ACCORDING TO PRIME MINISTER PRESS INTERVIEW, IS FOR CONSULTATIONS WITH LABOR AND TO CONSIDER NEW ECONOMIC MEASURES REQUIRED FOR THE LONGER RUN.

2. MEANWHILE THE DEVALUATION AND THE FAILURE TO PROVIDE IMMEDIATE RELIEF TO LOW-PAID WORKERS (CURRENT THEME IN GOVERNMENT CIRCLES) HAS LED ICELANDIC FEDERATION OF LABOR TO CAUCUS ITS MEMBERS AND AFFILIATES ON TERMINATING PRESENT CONTRACTS AS OF OCT 1. CONTRACTS FOR ALMOST ALL WORKERS EXCEPT FISHERMAN WOULD EXPIRE 30 DAYS LATER; FOR FISHERMEN, ABOUT SIX WEEKS LATER. THE IFL HAS TAKEN THIS ACTION (PRESUMABLY FOR LEVERAGE) WHILE AT THE SAME TIME NAMING MEMBERS TO A NEGOTIATING TEAM TO DEAL WITH THE GOVT IN UPCOMING TALKS. STRIKE THREATS HAVE NOT EXPLICITLY BEEN MENTIONED.

3. THE PARLIAMENT HAS ADJOURNED WITHOUT EXTENDING THE WAGE-PRICE FREEZE. TO KEEP IT IN FORCE BEYOND END OF SEPTEMBER GOVT MUST DO SO PROVISIONALLY WITH PARLIAMENT APPROVING RETROACTIVELY WHEN IT RECONVENES. THIS IS A SLIGHT BLOT ON GOVT IMAGE SINCE INDEPENDENCE PARTY CRITICIZED PREVIOUS REGIME FOR GOVERNING BY PROVISIONAL LAWS. MEANWHILE, THE COUNTRY MUST LIMP ALONG FOR TWO MONTHS WITH MAKESHIFT DEVICES FILLING ANY GAPS NOT TAKEN CARE OF BY FREEZE OR DEVALUATION.

4. SOME OF THE ACTIONS TAKEN BY THE PARLIAMENT AND PRICE REGULATION BOARD HELP EXPORTERS AND SHOPKEEPERS. (DETAILS WILL FOLLOW BY AIRGRAM). OTHERS INCREASE GOVT REVENUES, E.G. A 2 PERCENT INCREASE IN SALES TAX TO 19 PERCENT AND A 6 KRONUR PER LITER INCREASE IN GASOLINE TAX (UP TO ABOUT 36 CENTS PER LITER). IF THE GOVT APPROVES PRICE BOARD PROPOSALS, SHOPKEEPERS CAN INCREASE PRICES 6 PERCENT (IN ORDER TO EASE SQUEEZE ON PROFITS CAUSED BY DEVALUATION.) THE PARLIAMENT HAS TAKEN ACTION TO RECAPTURE SOME OF THE DEVALUATION WINDFALL FOR THE FISHING INDUSTRY PRICE EQUALIZATION FUND OR FOR OIL SUBSIDY PAYMENTS. MUCH OF THE ADDITIONAL EARNINGS WILL LIMITED OFFICIAL USE

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GO DIRECTLY TO EXPORTERS INCLUDING THE FROZEN FISH INDUSTRY, CURRENTLY OPERATING IN THE RED.

5. SOME INFORMATION HAS BEEN MADE AVAILABLE TO THE EMBASSY ON THE GOVERNMENTS EXPECTATIONS REGARDING THE BALANCE OF PAYMENTS. CONTRARY TO THE STATEMENT ISSUED BY THE CENTRAL BANK THAT THE DEVALUATION WOULD COVER THE 4 BILLION KRONUR TRADE DEFICIT (REFTTEL), WHICH FIGURE DID NOT CORRESPOND TO

PREVIOUS INFORMATION, THE 4 BILLION ITEM REFERS TO THE
OVERALL BALANCE OF PAYMENTS DEFICIT AS OF AUG 74
PRIOR TO DEVALUATION:

TRADE DEFICIT 9.8 BILLION KRONUR

SERVICES DEFICIT .4

BALANCE ON GOODS AND SERVICES 10.2

GIFTS, CONTRIBUTIONS ETC. .15 (SURPLUS)

CAPITAL ACCOUNT 6.05 (SURPLUS)

OVERALL DEFICIT 4.0

DRAWDOWN ON INTERNATIONAL RESERVES BY THE END OF THE
YEAR WILL BE ABOUT 5 BILLION. DEVALUATION WILL CUT
THIS BETWEEN 800 MILLION AND 1 BILLION KRONUR. NORMAL
EXPORTS WILL TAKE CARE OF ANOTHER BILLION. THE REMAINING
3 BILLION MUST BE TAKEN CARE OF BY (1) INCREASED EXPORTS
OF FISH STOCKS HELD IN ICELAND, AND (2) ADDITIONAL
CAPITAL INFLOWS DURING THE REMAINDER OF THE YEAR.

6. CENTRAL BANK OFFICIAL TOLD EMBOFF THAT IT WAS NOT YET
DECIDED WHETHER, IN ADDITION TO RECENT DRAWDOWN OF ICELANDS
IMF GOD TRANCHE, IT WOULD BE NECESSARY TO GO INTO THE
FIRST OR SECOND CREDIT TRANCHE. SOME HELP, HE SAID, WOULD
BE NEEDED IN CONNECTION WITH OIL IMPORT BILL.

7. COMMENT: GOVT ACTION TO DATE HAS NOT FOLLOWED ANY
SCRIPT SUGGESTED BY MEDIA REPORTS, I.E. QUICK MOVES BY
THE GOVT TO INTRODUCE NEEDED ECONOMIC MEASURES, A BUSY
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PARLIAMENT, AND AN EARLY HASSLE WITH LABOR OVER PRESUMABLY
IMPOSED TOUGH MEASURES. ALTHOUGH THE GOVT COALITION
CLAIMS TO BE AGREED WITHIN ITSELF ON THE MEASURES WHICH
NEED TO BE TAKEN TO MEET CURRENT ECONOMIC PROBLEMS, THIS
PRESENT SITUATION SUGGESTS THAT THE COALITION WILL FIND IT
NECESSARY TO CALL TIME OUT FOR EXTENSIVE DISCUSSIONS ON
STRATEGY WHENEVER A HARD DECISION HAS TO BE MADE.
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